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SUBJECT: KAZAKHSTAN'S URANIUM MARKET: KEY PLAYERS, PLANS, AND
PROSPECTS

REF: (A) 08 ASTANA 2232 (B) 08 ASTANA 2535

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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On January 15-16, Energy Officer met with top managers of Kazakhstan's state nuclear company Kazatomprom (KAP) and its foreign partners in Almaty, Kazakhstan's commercial hub. They discussed the role of international investors in Kazakhstan's uranium mining sector; plans to build a new nuclear power plant in Aktau; changes to the subsoil use law and tax code; and production constraints caused by the rising cost of capital, a dearth of qualified local personnel, and a lack of sulfuric acid for in-situ mining methods. KAP Vice President Sergei Yashin confirmed that KAP will fund the safe transportation and storage of spent fuel from the decommissioned BN-350 nuclear reactor in Aktau. END SUMMARY.

MONOPOLIST KAZATOMPROM MANAGES THE MARKETPLACE

13. (SBU) Kazatomprom, a state-owned holding company, is Kazakhstan's national uranium producer and operator of uranium exports. The company operates in six main areas: geological surveys, uranium production, metal making, power generation, scientific research, and technical training. Reftel A describes in detail the various operations of Kazatomprom and its joint ventures with nuclear power companies from Canada, France, and Japan that Energy Officer met in Almaty. On February 3, KAP President Mukhtar Dzhakishiev announced that revenue in 2008 would be 162 billion tenge (approximately \$1.33 billion), a 37 percent increase over 2007. Dzhakishiev also said that Kazatomprom produced 8,521 tons of uranium in 2008, and plans to produce 11,900 tons in 2009, which he said "will certainly make us number one in the world in uranium production."

14. (SBU) In contrast to Kazakhstan's oil and gas companies, which compete intensely against each other for exploration and production contracts, the rivalry among major foreign players in Kazakhstan's

uranium market is muted, because their contracts are carefully calibrated and awarded by the state-owned monopolist, Kazatomprom. Furthermore, there is a shared sense that Kazakhstan's uranium production potential has only begun to manifest itself. As Sergei Yashin, Vice President of Kazatomprom, put it, "There is enough work here for everyone. And each project is tailored to supply uranium to a specific export market." For example, the APPAK joint venture of Kazatomprom (65% ownership) and Japan's Sumitomo Corporation (25%) and Kansai Electric Power Co. (10%) enjoys long-term supply contracts with six Japanese companies and plans to sign two more in the near future. Similarly, Katko, a joint venture between KAP (49%) and France's Areva (51%), exports 100% of its uranium U308 to customers in France.

KAZATOMPROM CONSIDERED "A RELIABLE PARTNER"

15. (SBU) Without exception -- or prompting -- Kazatomprom's international partners spoke highly of the monopolist's management style and leadership. The comments of Paul Lewis Clarke, Senior Vice President of Canadian-based Uranium One, were typical. He praised KAP's President Mukhtar Dzhakishev and Vice President Askar Kassabekov for assembling an impressive team of well-educated, talented, young managers. He said Dzhakishev and Kassabekov are "very smart guys with a laser focus on business strategy and execution." Clarke added that KAP plays an active role in assisting the joint venture resolve tax, environmental, sulfur supply, and other critical issues with the government of Kazakhstan and he complimented KAP's technical staff for their expertise operating mines and conducting geological studies.

BUT NEW INTERMEDIARY HAS A SOVIET MENTALITY

16. (SBU) Although established in 2003, State Mining Company, a KAP subsidiary, only recently became the primary point of contact for KAP's international partners. All existing and future joint venture

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partners must now first agree with State Mining Company on business plans, personnel decisions, and investment strategies, before presenting recommendations to KAP. The joint venture partners who spoke to Energy Officer were universally critical of the new intermediary.

17. (SBU) Uranium One's Clarke said he was unable to make a simple but necessary technical adjustment because three key people from State Mining Company happened to be out of the office that day. Rinat Abduvaliyev, Director General of APPAK, said the additional level of bureaucracy means "we have at least one more document to be reviewed and approved before we can move." Pascal Lassus, Chief Financial Officer of Katko, was even more critical, calling the new entity, "just too much." Lassus said that Areva expressed its concerns about State Mining Company to KAP's Board of Directors and received a "positive response," but he lamented that nothing has changed. Lassus said State Mining Company follows Soviet management principles, stemming from the days when Soviet enterprises focused exclusively on meeting production targets set by the state plan and had no profit motive.

KAZATOMPROM VALUES ITS INTERNATIONAL PARTNERS ...

18. (SBU) When asked why Kazatomprom still needs foreign partners, KAP's Yashin said, "First of all, we require long-term financing on good terms. Second, we need to secure guaranteed sales, and all of our joint venture partners buy our products. And third, we receive value-added processing technology from our foreign partners. Kazatomprom does not want to be simply a mineral resource exporter anymore." When pressed, Yashin was surprisingly candid, even sentimental. He said that KAP particularly values its partnership with "American companies like Westinghouse and General Electric." (NOTE: Japan's Toshiba Group is the majority owner of the Westinghouse Electric Company, headquartered in Monroeville, Pennsylvania. Kazatomprom owns 10% of the company, but has no voting or veto rights or even a presence on the board of directors. END NOTE).

... AND INDEPENDENCE FROM RUSSIA

¶9. (SBU) Yashin bitterly recalled the tough times Kazakhstan experienced after the fall of the Soviet Union and said he felt betrayed and abandoned by Russia. "We kept waiting and waiting for our friends in Russia to resume relations and work with us as equal partners, but they treated us like illiterate nomads who ride horses and live in yurts. Now that we are back on our feet, Russian companies come to us to buy uranium and we just tell them to get lost." Yashin said Kazatomprom is "honored" to have worked with -- and learned from -- experts at Westinghouse and General Electric, "who were there when we needed them."

SAFE TRANSPORTATION AND STORAGE OF BN-350 SPENT FUEL

¶10. (SBU) KAP's Yashin assured Energy Officer that KAP will fund the safe transportation and storage of spent fuel from the decommissioned BN-350 nuclear reactor in Aktau. Yashin thanked Energy Officer for the assistance of the U.S. Department of Energy in decommissioning the reactor, and said, "This is Kazakhstan's business and we will take care of it," including building the necessary roads and storage facilities.

NUCLEAR INDUSTRY SHELTERED, BUT NOT IMMUNE, FROM CRISIS

¶11. (SBU) Kazatomprom and its joint venture partners acknowledge the adverse affect of the global financial crisis on business operations. Katco's Lassus said that Areva's June 2008 agreement to manufacture fuel assemblies at the Ulba Metallurgical Plant and sell them to France exist "only on paper." And Aliya Kayupova, Corporate Development Director for Inkai, a joint venture of Canada's Cameco and KAP, said that the Ulba conversion and sulfuric acid plant projects were put on hold for financial reasons. Nevertheless, the

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consensus was that Kazakhstan's civilian nuclear energy industry will be sheltered from the worst of the global financial crisis, mainly because KAP and its joint ventures have signed major long-term supply contracts ranging from five to 10 years. KAP's Yashin added that by 2030, the world's consumption of electrical power will double, and although nuclear power cannot meet this demand entirely, it will supply some of it.

SULFURIC ACID SUPPLY A COMMON CONSTRAINT

¶12. (SBU) The major constraint on uranium mining in Kazakhstan is the supply of sulfuric acid. Currently, companies buy sulfuric acid from Russia, Uzbekistan, and two companies in Kazakhstan -- Kazakhmys and KazZinc -- for which sulfuric acid is a byproduct. Both APPAK and Inkai are dissatisfied with the irregular supply and transportation costs of sulfuric acid and are planning to invest in new sulfuric acid processing facilities. Uranium One and Inkai praised KAP's success in securing a long-term supply of sulfur from Tengizchevroil (TCO), which produces more than two million tons of sulfur annually as a byproduct of oil production. Inkai's Kayupova indignantly described how she spent several months negotiating with TCO, which originally insisted on charging \$400 a ton, while she said Cameco was able to purchase sulfur for \$150 a ton. Kayupova said she visited Tengiz in 2008 with Kazatomprom Vice President Askar Kassabekov, who was "pissed off" by TCO's marketing officials.

According to Kayupova, TCO did not seem to care about their potential client, telling Kassabekov that they had eager buyers for their sulfur in more than 20 countries around the world. Kayupova said that Kassabekov subsequently had the government exert "a lot of pressure" on TCO to convince the company to sign a contract to supply the sulfur.

TAX AND LEGAL CHANGES

¶13. (SBU) Lassus of Katko is concerned by the proposed new Subsoil Law, which lacks a clause on international arbitration and has caused France's Areva to re-evaluate future investment in Kazakhstan. In general, however, the foreign investors Energy Officer consulted were not worried about changes to the Tax Code or the Subsoil Law. Uranium One's Clarke said his company recently extended its subsoil use agreement for the Kyzylkum mine until 2053, and the terms of the contract are already consistent with the new

laws, unlike contracts signed years ago by companies such as Inkai. "They got a sweet deal in the 1990s," according to Clarke, "so they will have to make more of an adjustment." Abduvaliyev of APPAK says that the new mineral extraction tax will lower the company's annual rate of return, but he predicted the affect on commercial operations would be offset by the lower corporate income tax rate.

ENVIRONMENTAL IMPACT OF URANIUM MINING

¶14. (SBU) Although KAP's joint ventures rely on a more environmentally friendly in-situ leaching method to extract uranium, mining operations nevertheless produce waste lakes, soil waste, and transportation emissions. As with all subsoil users, uranium mining companies are subject to quarterly inspections by regional and national environmental authorities. Katko's Lassus reported that his company had been fined previously for environmental violations, but he would not disclose the amount or reason.

WORK PERMITS NOT A MAJOR PROBLEM

¶15. (SBU) Some, but not all, of the international joint ventures working with KAP reported difficulty obtaining work permits for foreign employees. The problem appears less acute than in the oil and gas sector, although Katko's Lassus said it has affected the company's strategic planning. Inkai's KayupoQid that South Kazakhstan oblast, where Kazakhstan's uranium mines are located, historically has a low quota for expatriate workers, since there is little foreign investment in the region. Inkai has never raised the issue with regional authorities and reports that 95% of their

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employees are hired locally from neighboring villages. Kayupova said that in general, the local population in South Kazakhstan has a very positive attitude toward foreign uranium mining companies since they provide well-paying jobs with good benefits.

BUILDING LOCAL CAPACITY

¶16. (SBU) Nearly all companies consulted stressed the importance of building the technical capacity of local staff. Abduvaliyev of APPAK estimates that it takes up to 10 years to train a specialist. According to the terms of its contract with KAP, APPAK must spend at least one percent of total revenues on training and capacity-building activities. APPAK provides classroom training at Kazakhstan's Nuclear University (a Kazatomprom subsidiary) and the National Technical University, and offers a variety of mentoring and on-the-job training opportunities. Lassus said Areva trains its employees in Kazakhstan and in France and proudly cited the example of a Kazakhstani engineer who is currently working for Areva in Paris. Industry sources said that the most qualified technicians come from the Ulba Metallurgical Plant in Ust-Kamenogorsk and the Institute of Nuclear Physics in Almaty. Dr. Adil Tuleushev, Director of the Institute, complained that after several years of training at his institute, many employees leave for better paying jobs at Kazatomprom and its joint ventures.

NUCLEAR POWER PLANT TO BE BUILT IN AKTAU

¶17. (SBU) KAP's Yashin confirmed that the company plans to work with Russian partners to build a new nuclear power plant in Aktau, although he noted that the country currently derives 80% of its power from coal, and investments in nuclear power are unlikely to alter that ratio significantly. Yashin said the feasibility study for the Aktau nuclear power plant has been completed will be submitted to the government for review in April. Russia will supply two 300-megawatt reactors, analogous to those used in Russian nuclear submarines. The first block will be ready by 2016 and the second by 2018.

¶18. (SBU) The Institute of Nuclear Physics hopes to take part in this \$5 billion project by providing ecological monitoring and other services, which Tuleushev said might reach 10 percent of the total project cost. Tuleushev was nevertheless opposed to using a Russian-made, 300-megawatt reactor in Kazakhstan's nuclear power plants. He said the electricity grid of western Kazakhstan is isolated from the national power grid, which is much bigger and

requires larger reactors. As a result, technical and operational lessons learned would not be applicable to the rest of the country. Tuleushev is also concerned that the Russian-made 300-megawatt reactor has no competitors and Kazakhstan would be dependent on a monopoly supplier. According to Tuleushev, a 600-megawatt reactor built by Westinghouse and other companies could be used in central, northern, and eastern Kazakhstan and would be a better option. "We need a replicable, widely-applicable project," he said.

¶19. (SBU) COMMENT: It was interesting to note the difference in attitude between international oil companies and uranium mining companies doing business in Kazakhstan. The oil companies are very concerned by work permit restrictions, the new Tax Code, and proposed changes to the Subsoil Law, and are skeptical of the capacity of national oil company KazMunaiGas to advocate on behalf of the industry and manage complex projects independently. International uranium mining companies, however, expressed great faith and confidence in the leadership and management abilities of Kazatomprom and praised KAP's willingness to lobby the government, often with impressive results. END COMMENT.

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